

Message Text

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TO USDEL SECRETARY PRIORITY

C O N F I D E N T I A L STATE 292212 TOSEC 310365

FOR UNDER SECRETARY ROGERS FROM SORENSON

FOLLOWING REPEAT LONDON 19262 ACTION SECSTATE 30 NOV 76

QUOTE

C O N F I D E N T I A L LONDON 19262

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E.O. 11652: GDS

TAGS: EFIN, UK

SUBJECT: SITUATION REPORT, NOVEMBER 30

REF: (A) STATE 267168; (B) LONDON 19170

1. EMERGING CABINET VIEW ON ECONOMIC MEASURES. THE
PRESS HAS CONTINUED TO SPECULATE--OFTEN DRAWING ON WHAT
APPEAR TO BE AUTHORITATIVE SOURCES -- ON THE CABINET'S
POSITION REGARDING THE MEASURES TO BE TAKEN AS CONDI-
TIONS FOR THE 3.9 BILLION IMF LOAN. ALTHOUGH DETAILS
VARY, THE CENTRAL THRUST OF ALL THE STORIES IS THAT A
SUBSTANTIAL MAJORITY OF THE CABINET OPPOSES ANY ACTIONS
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WHICH WOULD HAVE A SIGNIFICANTLY DEFLATIONARY EFFECT ON

THE ECONOMY. VIRTUALLY ALL PRESS ACCOUNTS REPORT THAT CHANCELLOR HEALEY, SUPPORTED BY TRADE SECRETARY DELL AND ODM MINISTER PRENTICE, HAS BEEN ATTEMPTING TO PREPARE THE GROUND FOR A PACKAGE WHICH WOULD ACHIEVE A MAJOR REDUCTION IN THE PUBLIC SECTOR BORROWING REQUIREMENT, THROUGH SOME COMBINATION OF FURTHER CUTS IN PUBLIC SPENDING AND INCREASED INDIRECT TAXATION. CABINET OPPOSITION TO THIS APPROACH IS REPORTEDLY LED BY FOREIGN SECRETARY CROSLAND, ENVIRONMENT SECRETARY SHORE AND CHANCELLOR OF THE DUCHY OF LANCASTER LEVER, WHO ARGUE THAT SUCH ACTION WOULD PUSH THE ECONOMY INTO RECESSION, INCREASE UNEMPLOYMENT AND DELAY RECOVERY. MOST OF THE CABINET REPORTEDLY FIND THIS ARGUMENT PERSUASIVE -- WHILE THE PRESS ACCOUNTS OF THE LINE-UP VARY, LEVER TOLD AN EMBOFF THAT TWO-THIRDS OF THE CABINET NOW OPPOSE THE TREASURY RECOMMENDATION. PRIME MINISTER CALLAGHAN HAS APPARENTLY NOT YET TIPPED HIS HAND. WE WOULD NOT VENTURE TO PREDICT THE ULTIMATE DECISITN. HOWEVER, THE EMERGING CABINET CONSENSUS. AND THE VIEWS OF THE TUC AND LABOR BACKBENCHERS, ARE BOUND TO WEIGH HEAVILY WITH CALLAGHAN, WHO IS A HIGHLY POLITICAL ANIMAL.

2. LE HURRAY, TUC GENERAL SECRETARY HAS THROWN HIS FULL WEIGHT INTO THE ARGUMENT OVER THE SIZE OF THE AUSTERITY PACKAGE NECESSARY TO MEET IMF DEMANDS. MURRAY, ACCORDING TO THE "TIMES" NOVEMBER 30, HAS WARNED THAT ANY CONDITIONS TO THE PROPOSED IMF LOAN WHICH WOULD INVOLVE DEFLATION AND STRINGENT CUTS IN PUBLIC SPENDING WOULD THREATEN THE SOCIAL CONTRACT. THE "TIMES" INDICATED THAT MURRAY HAS WARNED IMF OFFICIALS THAT IF HARD DEFLATIONARY ACTIONS WERE TAKEN, THE TRADE UNIONS MIGHT OPT FOR A TOUGH ECONOMIC POLICY INCLUDING WIDESPREAD IMPORT CONTROLS. (IT ADDS, HOWEVER, THAT SOME TUC GENERAL COUNCIL MEMBERS - LORD ALLEN AND TOM JACKSON - CHALLENGED MURRAY'S TOUGH TALK.) MURRAY'S WARNING DOES NOT COME AS A SURPRISE, OF COURSE, SINCE THE TRADE UNIONS HAVE CLEARLY AND CONSISTENTLY OPPOSED A TOUGH AUSTERITY PACKAGE. IT IS ALSO CLEAR THAT MURRAY IS USING THE WEIGHT OF THE TUC - WHICH IS CRITICAL - IN FAVOR OF THE SOFT-LINERS IN THE CABINET WHO ARE TAKING

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A SIMILAR POSITION - THAT TOUGH DEFLATIONARY ACTIONS WOULD BE POLITICALLY DANGEROUS. MURRAY'S VOICE IS THUS ADDED TO THOSE OF INDIVIDUAL UNION LEADERS, THE CONFEDERATION OF BRITISH INDUSTRY. AND THE NEO-KEYNESIANS. THIS RATHER DISPARATE GROUP IS OPPOSED TO INCREASING UNEMPLOYMENT SHARPLY IN THE SHORT RUN AS SPENDING CUTS AND CREDIT RESTRAINT BEGIN TO BITE. AS A CONSTELLATION OF POLITICAL FORCES, THEIR WEIGHT IS FAR FROM NEGLIGIBLE.

WHILE NOT FULLY AGREED ON WHAT IS TOLERABLE, THEY HAVE BEEN SKETCHING THE BOUNDARIES WITHIN WHICH AN HMG-IMF ACCORD SHOULD FALL.

3. CONGRESSMAN REUSS ADDRESSED A LONDON INVESTORS CONFERENCE YESTERDAY; HE WARNED AGAINST SHARP SPENDING CUTS WHICH HE DESCRIBED AS A MISTAKEN CONDITION FOR THE IMF DRAWING. CALLING BRITAIN'S BASIC PROBLEMS STRUCTURAL, HE SAID THEY COULD ONLY BE SOLVED WHEN BOTH UNEMPLOYMENT LEVELS AND BUSINESS CONFIDENCE WERE AT REASONABLE LEVELS. HE ADDED THAT "IT WAS NOT FOR THE US TO IMPOSE THE WRONG REMEDIES ON THE UK IN HER FINANCIAL AGONY". REUSS RULED OUT ANY USG ACTION TO FUND

STERLING BALANCES. RATHER, HE SUGGESTED IN A BBC RADIO INTERVIEW THAT HOLDERS OF STERLING BALANCES SHOULD BE OFFERED THE OPPORTUNITY TO CONVERT THESE INTO 10-20 YEARS OBLIGATIONS DENOMINATED PERHAPS IN SDRS OR IN HARD CURRENCIES TO BE REPAID BY BRITAIN OUT OF NORTH SEA OIL REVENUES.

4. THE CALL BY THE NATIONAL UNION OF MINERS EXECUTIVE FOR INDUSTRIAL ACTION WHICH COULD INCLUDE A NATIONAL STRIKE WAS BOLSTERED BY REACTION FROM A NUMBER OF KEY REGIONAL GROUPS IN YORKSHIRE, SCOTLAND AND SOUTH WALES, THE THREE MOST MILITARNT AREAS IN THE NUM, WHERE LEADERSHIP MEETINGS URGED MINERS TO VOTE IN FAVOR OF THE NUM EXECUTIVE'S CALL UNLESS THE NATIONAL COAL BOARD MEETS DEMANDS ON EARLY RETIREMENT. THERE IS LIKELY TO BE SUBSTANTIAL SUPPORT FROM ALL AREAS FOR THE EXECUTIVE'S CALL FOR AUTHORIZATION OF SOME FORM OF INDUSTRIAL ACTION WHEN THE VOTE IS ANNOUNCED ON DECEMBER 14, AND THE NATIONAL COAL BOARD WILL BE ATTEMPTING TO COMPROMISE

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THE DISPUTE.

A LEADING NCB OFFICIAL HAS ACKNOWLEDGED TO US THAT BRITAIN IS AT THE "BOTTOM OF THE EUROPEAN PILE" BY HAVING THE POOREST RETIREMENT BENEFITS. PAUL ROUTLEDGE, WHO TALKED TO YORKSHIRE MINERS ON THE ISSUE, SAYS (TIMES, NOV 30) THERE IS "A SENSE OF ANGER AND FRUSTRATION EVIDENT" AMONG THE MINERS IN THAT AREA AND "BITTERNESS" FROM MEN SUFFERING FROM COAL DISEASES "WHO FEAR THEY WILL NOT LIVE LONG ENOUGH TO ENJOY THE FRUITS OF THE DISPUTE...".

THERE IS A DANGER THAT THE MILITANTS FROM THESE AREAS MAY TRY TO GET THE NUM TO "GO FOR BROKE BY INSISTING ON THE FULL DEMAND FOR EARLY RETIREMENT BE MET

(BY AGE 60 IN JANUARY 1977 AND 55 STARTING IN 1980).
THE NATIONAL COAL BOARD WILL NOT BE ABLE TO ACCEPT THIS
EXTREMELY COSTLY PROPOSAL. HOWEVER, A COMPROMISE
SOLUTION STILL SEEMS LIKELY.

5. SPENDING CUTS - HOUSING. H.M. TREASURY IS REPORTED
BY THE TIMES TO BE PROPOSING LARGE CUTS IN GOVERNMENT
HOUSING SUBSIDIES. CURRENTLY, TENANTS IN PUBLIC HOUSING
PAY ONLY 43 PERCENT OF THE RENT CHARGE WITH THE GOVERN-
MENT SUBSIDIZING THE REMAINING 57 PERCENT. IT HAD BEEN
PLANNED TO REDUCE THIS SUBSIDY TO 50 PERCENT OVER A
PERIOD OF 5 YEARS. H.M. TREASURY IS PUSHING FOR AN
EARLIER REDUCTION OF MORE SUBSTANTIAL PROPORTIONS. SUB-
SIDIZED RENTS ARE A KEY ELEMENT IN THE SOCIAL CONTRACT
BETWEEN UNIONS AND GOVERNMENT. HIGHER RENTS RESULTING
FROM THE TREASURY PROPOSAL WOULD PLACE FURTHER STRAIN
ON THAT AGREEMENT.

6. EC SUMMIT. AT THE EUROPEAN COUNCIL MEETING IN THE
HAGUE, THE PRIME MINISTER IS REPORTED TO HAVE ARGUED
STRONGLY AGAINST ANY DEVALUATION OF THE GREEN POUND. HE
CITED THE FRAGILITY OF THE SOCIAL CONTRACT WITH ORGAN-
IZED LABOR, WHICH WOULD BE STRAINED BY RESULTING HIGHER
FOOD PRICES. CALLAGHAN'S DEFENSE CAME IN THE WAKE OF
GISCARD D'ESTAING'S CRITICISM OF THE INCREASING DRAIN
OF GREEN CURRENCY SUBSIDIES ON THE COMMUNITY BUDGET.
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THE FT REPORTS THAT CALLAGHAN IS TO HAVE BREAKFAST WITH
SCHMIDT TODAY TO DISCUSS THE POSSIBILITY OF ADDITIONAL

SUPPORT MEASURES FOR STERLING BEYOND THE \$3.9 BILLION
IMF LOAN.

7. IMF MONITORING OF UK. A FINANCIAL TIMES ARTICLE
SPECULATES THAT THE IMF LOAN WILL BE MADE IN INSTALMENTS
AS IT MONITORS THE UK'S ECONOMIC PERFORMANCE. THE IMF
IS SAID TO BE INTERESTED PRIMARILY IN THE SIZE OF
DOMESTIC CREDIT EXPANSION ALTHOUGH IT HAS NOT INDICATED
SPECIFIC TARGET FIGURES. WORK IN H.M. TREASURY IS SAID
TO BE FOCUSING ON CUTS IN "SPENDING"--NOTABLY TRANSFER
PAYMENTS--WHICH EXCEED 1 BILLION POUNDS.

8. MILTON FRIEDMAN'S "60 MINUTES" INTERVIEW GOT HEAVY
PRESS PLAY BUT HIS VIEWS WERE CRITICIZED FOR THEIR
NAIVETE.

9. FOREIGN EXCHANGE AND FINANCE. ALL MARKETS MOVED
QUIETLY ON MONDAY, AS BUYERS AND SELLERS OF ALL ASSETS
WERE SAID TO BE SHOWING CAUTION WHILE THE IMF CONCLUDES

ITS DELIBERATIONS ON THE \$3.9 BILLION CREDIT. STERLING
CLOSED MONDAY AT \$1.6485 UNCHANGED FROM FRIDAY'S CLOSE.
EQUITY PRICES WERE ON THE AVERAGE VIRTUALLY UNCHANGED
AS THE FINANCIAL TIMES INDEX OF 30 INDUSTRIALS CLOSED
MONDAY AT 302.5 COMPARED WITH FRIDAY'S 302.4 CLOSING.
GILT PRICES EASED SLIGHTLY, ON THE ORDER OF 1/16.

EARLY TUESDAY TRADING SAW CONTINUED QUIET IN
MARKETS. STERLING TRADED IN THE NEIGHBORHOOD OF MONDAY'S
CLOSE. THE FINANCIAL TIMES INDEX EASED TO 300.3 AT
10:00. GILT PRICES, HOWEVER, CONTINUED TO FALL, THE
DECLINES IN THE SHORTS BEING ON THE ORDER OF 1/16 AND
ON LONGS 1/4.

THE HIGH INTEREST RATES THAT HAVE PREVAILED
IN THE MONEY MARKET DURING THE LAST FEW WEEKS HAVE LED
FINANCE HOUSES TO INCREASE THEIR BASE RATE FROM 14 TO
15 PERCENT.

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ARMSTRONG.
UNQUOTE ROBINSON.

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